

STATE OF MICHIGAN
DEPARTMENT OF
ENVIRONMENT, GREAT LAKES, AND ENERGY

ORDER OF THE SUPERVISOR OF WELLS

IN THE MATTER OF:

THE PETITION OF NUENERGY OPERATING, INC. FOR)	
AN ORDER FROM THE SUPERVISOR OF WELLS FOR)	
STATUTORY POOLING ALL INTERESTS INTO A)	
40-ACRE TRENTON/ BLACK RIVER FORMATION)	ORDER NO. 06-2019
DRILLING UNIT IN LEE TOWNSHIP, T1S-R5W, CALHOUN)	
COUNTY, MICHIGAN.)	

OPINION AND ORDER

This case involves the Petition of NuEnergy Operating, Inc. ("Petitioner"), to statutorily pool all unleased interests into a 40-acre drilling unit in order to drill and complete the proposed Mather B2-34 well within the stratigraphic interval known as the Trenton/Black River Formation. The proposed unit consists of the SE/4 of the NW/4 of Section 34, T1S, R5W, Lee Township, Calhoun County, Michigan. Since not all of the mineral owners within the proposed unit have agreed to lease their interests, the Petitioner seeks an Order of the Supervisor of Wells ("Supervisor") designating the Petitioner as Operator of the 40-acre drilling unit and requiring statutory pooling of all tracts and interests within that geographic area where the owners have not agreed to lease and voluntarily pool.

Jurisdiction

The development of oil and gas in this state is regulated under Part 615, Supervisor of Wells, of the Natural Resources and Environmental Protection Act, 1994 PA 451, as amended, MCL 324.61501 *et seq.* The purpose of Part 615 is to ensure the orderly development and production of the oil and gas resources of this state. MCL 324.61502. To that end, the Supervisor may establish drilling units and statutorily pool mineral interests within said units. MCL 324.61513(2) and (4). However, the formation of drilling units by statutory pooling of interests can only be effectuated after an evidentiary

hearing. 1996 MR 9, R 324.302, and R 324.304. The evidentiary hearing is governed by the applicable provisions of the Administrative Procedures Act, 1969 PA 306, as amended, MCL 24.201 *et seq.* See 1996 MR9, R 324.1203. The evidentiary hearing in this matter was held on July 29, 2019.

FINDING OF FACTS

The Petitioner specifically requests that the Supervisor issue an Order that:

1. Requires statutory pooling of all tracts and mineral interests within the proposed Trenton/Black River Formation drilling unit that have not agreed to lease and voluntarily pool.
2. Names the Petitioner as Operator of the Mather B2-34 well.
3. Authorizes the Petitioner to recover certain costs and other additional compensation from the parties subject to the statutory pooling order.

The Supervisor determined the Notice of Hearing was properly served and published. No answers in opposition to the Petition were filed. Therefore, Petitioner is the only party to this case. The Supervisor designated the hearing to be an uncontested evidentiary hearing pursuant to R 324.1205(1)(c) and directed evidence to be presented in the form of verified statements pursuant to R 324.1205(2).

In support of its case, the Petitioner offered the verified statements of Jeffrey A. Smetzer, President of NuEnergy Operating, Inc. and Dean Bohjanen, Petroleum Geologist and consultant for the Petitioner.

I. Drilling Unit

The spacing of wells in Calhoun County targeting the Trenton-Black River Formations is governed by Supervisor's Order No. 18-2007. This Order establishes drilling units of 40 acres. Under Order No. 18-2007, it is presumed that one well will efficiently and economically drain the 40-acre drilling unit of hydrocarbons. The Petitioner's 40-acre proposed drilling unit is described as the SE/4 of the NW/4 of Section 34, T1S, R5W, Lee Township, Calhoun County, Michigan and fully complies with Order No. 18-2007.

II. Drilling Unit Operator

Mr. Smetzer's verified statement indicates that the Petitioner controls all oil and gas leases in the proposed drilling unit except for 4.3488 net acres in the proposed drilling unit. Given this, the Petitioner seeks to be designated as the Operator of the Mather B2-34 well. I find, as a Matter of Fact, the Petitioner is eligible to be designated Operator of the Mather B2-34 well.

III. Statutory Pooling

The Petitioner was unable to obtain the agreement of all mineral owners to gain full control of the proposed unit. The Petitioner may not produce a well on the drilling unit without first obtaining control of all the oil and gas interests. In cases like this, it is necessary for the Petitioner to request statutory pooling from the Supervisor. As discussed, a mineral owner who does not agree to voluntarily pool his or her interest in a drilling unit may be subject to statutory pooling. 1996 MR 9, R 324.304. The statutory pooling of an interest must be effectuated in a manner that ensures "each owner . . . is afforded the opportunity to receive his or her just and equitable share of the production of the unit." *Id.* In addition to protecting correlative rights, the statutory pooling must prevent waste. MCL 324.61502. An operator must first seek voluntary pooling of mineral interests within a proposed drilling unit prior to obtaining statutory pooling through an Order of the Supervisor.

Mr. Smetzer states that the Petitioner controls 35.6512 net acres of oil and gas interests within the proposed 40-acre drilling unit. Mr. Smetzer's verified statement and affidavit of leasing efforts (exhibit 3) indicate that Petitioner has made both oral and written attempts to obtain an oil and gas lease from the unleased owners and that these owners were offered fair, reasonable, and appropriate lease terms. The owners of oil and gas interests that are not leased are:

<u>Name</u>	<u>Net Mineral Acres</u>
Pang Kue and Paula Malott	0.45 0.60
Todd & Lori Squires, husband and wife	1.979
Ronald Woycehoski, a single man	0.0792
Leede Operating Company, LLC	0.2969
Estate of Nina Belle Grozinger	0.7187
Feril I. Russell f/k/a Feril I. Mather	0.225
Total Unleased Interests:	4.3488

Based on the foregoing, I find, as a Matter of Fact:

1. The Petitioner was able to voluntary pool all of the mineral interests in the proposed 40-acre drilling unit except for the acreage described above.
2. Statutory pooling is necessary to form a full drilling unit, to protect correlative rights of unpooled lease owners, and to prevent waste by preventing the drilling of unnecessary wells.

Now that it has been determined that statutory pooling is necessary and proper in this case, the terms of such pooling must be addressed. When pooling is ordered, the owner of the statutorily pooled lands (Pooled Owner) is provided an election on how he or she wishes to share in the costs of the project. 1996 MR9, R 324.1206(4). A Pooled Owner may participate in the project or, in the alternative, be "carried" by the Operator. If the Pooled Owner elects to participate, he or she assumes the economic risks of the project, specifically, by paying his or her proportionate share of the costs or giving bond for the payment. Whether the well drilled is ultimately a producer or dry hole is immaterial to this obligation. Conversely, if a Pooled Owner elects not to participate, the Pooled Owner is, from an economic perspective, "carried" by the Operator. Under this option, if the well is a dry hole, the Pooled Owner has no financial obligation because they did not assume any risk. If the well is a producer, the Supervisor considers the risks associated with the proposal and awards the Operator compensation, out of production, for assuming all of the economic risks.

In order for a Pooled Owner to decide whether he or she will “participate” in the well or be “carried” by the Operator, it is necessary to provide reliable cost estimates. In this regard, the Petitioner must present proofs on the estimated costs involved in drilling, completing, and equipping the proposed well. The Petitioner’s Authorization for Expenditure (“AFE”) form for the Mather B2-34 well (Exhibit 4 of NuEnergy’s Joint Exhibits) itemizes the estimated costs to be incurred in the drilling, completing, equipping, and plugging of the well. The estimated costs are \$665,850.00 for drilling, \$254,750.00 for completion, and \$281,300.00 for equipping. The total estimated producing well cost of the Mather B2-34 is \$1,201,900.00. *Id.* There is no evidence on this record refuting these actual or estimated costs.

I find, as a Matter of Fact, the estimated costs in Exhibit 4 are reasonable for the purpose of providing the Pooled Owner(s) a basis on which to elect to participate or be carried. However, I find actual costs shall be used in determining the final share of costs and additional compensation assessed against a Pooled Owner.

The next issue is the allocation of these costs. Part 615 requires the allocation be just and equitable. MCL 324.61513(4). According to Mr. Bohjanen’s verified statement, a 40-acre drilling unit is necessary to provide equitable treatment to all mineral owners within the unit. The Petitioner requests the actual well costs and production from the well be allocated based upon the ratio of the number of mineral acres in the tracts of the various owners to the total number of mineral acres in the drilling unit. Established practices and industry standards suggest this to be a fair and equitable method of allocation of production and costs. Therefore, I find, as a Matter of Fact, utilizing net mineral acreage is a fair and equitable method to allocate to the various tracts in the proposed drilling unit each tract’s just and equitable share of unit production and costs. I find that an owner’s share in production and costs should be in proportion to their net mineral acreage.

The final issue is the additional compensation for risk to be assessed against a Pooled Owner who elects to be carried. The Administrative Rules under Part 615 provide for the Supervisor to assess appropriate compensation for the risks associated with drilling a dry hole and the mechanical and engineering risks associated with the completion and equipping of wells. 1996 MR 9, R 324.1206(4)(b). The Petitioner

requests additional compensation of 300 percent for the costs of drilling, 200 percent of completing, and 100 percent of equipping the Mather B2-34 well. Mr. Bohjanen testified that drilling risks are significant and that a project of this nature presents many challenges including mechanical and engineering risks.

I find, as a Matter of Fact, the risk of the Mather B2-34 well, being a dry hole does support additional compensation from the Pooled Owner of three hundred percent (300%) of the actual drilling costs incurred. I find the mechanical and engineering risks associated with the well support additional compensation of two hundred percent (200%) of the actual completing costs and one hundred percent (100%) of the actual equipping costs incurred. Operating costs are not subject to additional compensation for risk.

CONCLUSIONS OF LAW

Based on the Findings of Fact, I conclude, as a matter of law:

1. The Petitioner was unable to voluntarily pool all mineral interests within the proposed drilling unit. The Supervisor may statutorily pool properties when pooling cannot be agreed upon. Statutory pooling is necessary to prevent waste and protect the correlative rights of the Pooled Owner in the proposed drilling unit. MCL 324.61513(4).
2. This Order is necessary to provide for conditions under which each mineral owner who has not voluntarily agreed to pool all of their interest in the pooled unit may share in the working interest share of production. 1996 MR9, R 324.1206(4).
3. The Petitioner is an owner within the drilling unit, and therefore, is eligible to drill and operate the Mather B2-34 well. 1996 MR9, R 324.1206(4).
4. The Petitioner is authorized to take from each nonparticipating interest's share of production, the cost of drilling, completing, equipping, and operating the well, plus an additional percentage of the costs as the Supervisor considers appropriate for the risks associated with drilling dry hole, and the mechanical and engineering risks associated with the completion and equipping of the well. 1996 MR 9, R 324.1206(4).
5. Spacing for wells drilled in Calhoun County to the Trenton/Black River Formation is 40 acres as set by Order 18-2007.

6. The Supervisor has jurisdiction over the subject matter and the persons interested therein.

7. Due notice of the time, place, and purpose of the hearing was given as required by law and all interested persons were afforded an opportunity to be heard.

1996 MR 9, R 324.1204.

DETERMINATION AND ORDER

Based on the Findings of Fact and the Conclusions of Law, the Supervisor determines that statutory pooling to form a 40-acre Trenton-Black River Formation drilling unit is necessary to protect correlative rights and prevent waste by the drilling of unnecessary wells.

NOW, THEREFORE, IT IS ORDERED:

1. A 40-acre Trenton-Black River Formation drilling unit is established pursuant to Order 18-2007, for the Mather B2-34 well comprising the SE/4 of the NW/4 of Section 34, T1S, R5W, Lee Township, Calhoun County, Michigan. All properties, parts of properties, and interests in this area are pooled into the drilling unit. This pooling is for the purpose of forming a drilling unit only.

2. Each Pooled Owner shall share in production and costs in the proportion that their net mineral acreage in the drilling unit bears to the total acreage in the unit.

3. The Petitioner is named Operator of the Mather B2-34 well. The Operator shall commence the drilling of the Mather B2-34 well within 90 days of the effective date of this order, or the statutory pooling authorized by this order shall be null and void as to the parties and interests. This pooling order applies to the drilling of the Mather B2-34 well and any directional redrills from that well.

4. A Pooled Owner shall be treated as a working interest owner to the extent of 100 percent of the interest owned in the drilling unit. The Pooled Owner is considered to hold a 1/8 royalty interest, which shall be free of any charge for costs of drilling, competing, or equipping the well, or for compensation for the risks of the well or operating the proposed well including post-production costs.

5. A Pooled Owner shall have ten (10) days from the effective date of this Order to select one of the following alternatives and advise the Supervisor and the Petitioner, in writing, accordingly:

- a. To participate, then within ten (10) days of making the election (or within a later date as approved by the Supervisor), pay to the Operator the Pooled Owner's share of the estimated costs for drilling, completing, and equipping the well, or give bond to the operator for the payment of the Pooled Owner's share of such cost promptly upon completion; and authorize the Operator to take from the Pooled Owner's remaining $7/8$ share of production, the Pooled Owner's share of the actual costs of operating the well; or
- b. To be carried, then if the well is put on production, authorize the Operator to take from the Pooled Owner's remaining $7/8$ share of production:
 - (i) The Pooled Owner's share of the actual cost of drilling, completing, and equipping the well.
 - (ii) An additional 300 percent of the actual drilling costs, 200 percent of the actual completion costs, and 100 percent of the actual equipping costs attributable to the Pooled Owner's share of production, as compensation to the Operator for the risk of a dry hole.
 - (iii) The Pooled Owner's share of the actual cost of operating the well.

6. In the event the Pooled Owner does not notify the Supervisor, in writing, of the decision with ten (10) days from the effective date of this Order, the Pooled Owner will be deemed to have elected the alternative described in Paragraph 5(b). If a Pooled Owner who elects the alternative in Paragraph 5(a) does not, within ten (10) days of making their election (or within any alternate date approved by the Supervisor), pay their proportionate share of costs or give bond for the payment of such share of such costs, the Pooled Owner shall be deemed to have elected the alternative described in Paragraph 5(b), and the Operator may proceed to withhold and allocate proceeds for

costs from the Pooled Owner's 7/8 share of production as described in Paragraph 5(b)(1), (ii) and (iii).

7. For purposes of the Pooled Owner electing an alternative, the amounts of \$665,850.00 for estimated drilling costs; \$254,750.00 for estimated completion costs; and \$281,300.00 for estimated equipping costs are fixed as well costs. Actual costs shall be used in determining the Pooled Owner's final share of well costs. If a Pooled Owner has elected the alternative in Paragraph 5(a) and the actual cost exceeds the estimated cost, the Operator may recover the additional cost from the Pooled Owner's 7/8 share of production. Within sixty (60) days after commencing drilling of the well, and every thirty (30) days thereafter until all costs of drilling, completing, and equipping the well are accounted for, the Operator shall provide to the Pooled Owner a detailed statement of actual costs incurred as of the date of the statement and all costs and production proceeds allocated to that Pooled Owner.

8. The Operator shall certify to the Supervisor that the following information was supplied to each Pooled Owner no later than the effective date of the Order:

- a. The Order;
- b. The AFE;
- c. Each Pooled Owner's percent of charges from the AFE if the Pooled Owner were to choose option "a" in Paragraph 5, above.


9. A Pooled Owner shall remain a Pooled Owner only until such time as a lease or operating agreement is entered into with the Operator. At that time, terms of the lease or operating agreement shall prevail over terms of this Order.

10. This Order shall terminate immediately after the Mather B2-34 well, and all directional redrills therefrom, have been plugged and abandoned.

11. The Supervisor retains jurisdiction in this matter.

12. The effective date of this Order is September 14, 2019.

DATED: September 4, 2019


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